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BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

STB EX PARTE NO. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

COMMENT OF THE AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION

Keith T. Borman
Vice President & General Counsel
American Short Line and Regional Railroad Association
Suite 7020
50 F Street N.W.
Washington, D.C. 20001-1564
Telephone 202-628-4500
Fax: 202-628-6430
Email: kborman@aslrra.org

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The American Short Line and Regional Railroad Association ("ASLRRA") respectfully submits its Comments concerning the Board's proposed standards concerning simplified rail rate case proceedings These comments are submitted in response to the January 22, 2007 Decision by the Board soliciting public comment on the proposed standards and hearing testimony.

Statement of Interest

ASLRRA represents approximately 425 class II and class III railroads in the United States, Canada and Mexico as well as numerous suppliers and contractors to the short line and regional railroad industry. ASLRRA thanks the Surface Transportation Board for inviting the comments of interested parties.

Comments

ASLRRA is pleased to accept the Board's invitation to comment on testimony given at the January 31, 2007 Hearing on Simplified Standards for Rail Rate Cases. While neither ASLRRA nor most of its members has enough experience with the arcane details of rate cases and the URCS that underpins much of their analyses, it is clear from the testimony and prior written Comments that small railroads indeed have much at stake in this proceeding. In these Comments ASLRRA will focus on the reasons the rulemaking proposed by the Board is a more fundamental threat to the viability of small railroads than it is to the large Class I carriers.

Fortunately, many of the problems which the small and medium size case procedures present to Class II and Class III railroads have already been explored in depth in the previous Comments and the hearing testimony of the Kansas City Southern Railroad. ASLRRA thanks KCS for so clearly articulating the danger to smaller railroads which this rulemaking represents, and it fully supports the positions KCSR has taken on the issues. While it would not be useful to repeat in detail the points KCSR has already so ably made, it is worth noting briefly why KCSR was correct in citing their applicability to even the smallest Class II and Class III carriers.

All the methodologies for assessing small and medium size rate cases are URCS based, and if a Class I carrier like KCSR admits to unfamiliarity with the esoterica of URCS, Class II and especially Class III carriers are utterly clueless. In terms of staff URCS expertise, access to affordable URCS professional guidance and state of the art

URCS record retention, most are completely empty-handed. And why shouldn't they be? Imposing a system on these small businesses which is well-understood by literally only a handful of Washington's most expensive lawyers and economists borders on an abuse of due process. In setting their rates in the first place the overwhelming majority of small railroads would not possibly be able to determine whether those rates would stand up to an URCS based challenge without the extensive and expensive assistance of cadres of experts and professional consultants. Yet the specter of numerous small rate cases would require that even the humblest carriers become savvy in the intricacies of URCS based pricing. That is not only unrealistic; it is fundamentally unfair.

Besides the operating costs associated with functioning in an URCS-driven environment, the cost of actually defending multiple 'simplified' rate cases would be a threat to the financial viability of many small carriers. Expert testimony at the January 31 hearing estimated that defending the simplest case would cost $50,000 to $100,000. ASLRRA believes that even the high end of that range would in practice constitute a baseline for defending a 'small' rate case if all associated costs are considered. One reason is - as with so many other regulatory-related costs - there simply is no economy of scale for small railroads. Each defense must be built from the ground up; in contrast to the resource-rich class I carriers small railroads have no 'in-house' counsel who make a career of specializing in rate matters, no economists nor statisticians on retainer, no record retention departments who can summon any volume of documents on short notice to mount an effective defense. If a small carrier is forced to defend enough cases to develop such class I-like economies of scale, those "economies" will necessarily put the

small carrier out of business. ASLRRA estimates that the average class III railroad revenues for the year 2005 were approximately $3.5 million. Just three 'small rate cases' could potentially cost the average class III railroad 10% of its revenues. Operating on slimmer margins than any class I railroad, the average small carrier simply cannot absorb defense costs at this level and expect to remain in business.

In its second concern about the proposed rulemaking, expressed in both its Comments and its hearing testimony, KCSR explained in detail why unadjusted URCS, the driver for the small rate case methodologies proposed by the Board, is inherently biased against small railroads. ASLRRA supports this conclusion. Phase I of the URCS analysis runs regressions based on a collection of class I railroad data over time covering a variety of cost measures including mileage, ton miles and other inputs. KCSR noted that unadjusted URCS understates costs for KCSR because it is the smallest of the class I railroads whose data drive the unadjusted URCS analysis. URCS's distortion of class II and class III costs – whose actual cost data is qualitatively and quantitatively different from the class I carriers - is exponentially worse. For example, as noted by KCSR, small railroad costs are more functions of time than mileage. This presents a special problem for class II and class III railroads. Not only are a greater portion of their costs related to switching, spotting of cars and other pickup and delivery related activities, but even their shorter line haul costs are underestimated because class II and class III railroads typically operate at much slower speeds than large railroads, thus creating higher actual costs per mile for many individual movements than the class I derived unadjusted URCS would predict.

This result was clearly demonstrated by the Verified Statement of George C. Woodward, incorporated into the KCSR November 30, 2006 Comment, in which he reported that his comparison study revealed that URCS underestimated KCSR's actual costs by 30 percent. While ASLRRA does not have the resources to commission its own study, Mr. Woodward noted in his analysis that the underestimation of costs for class II and class III railroads would also result from an URCS comparison. ASLRRA is confident the Board will concede that the underestimation for the class II and class III carriers would clearly be even greater than for the mid-sized KCSR.

Similarly, KCSR explained in some detail why unadjusted URCS understates its cost of capital because URCS' cost of capital determination is a function of class I regional industry averages. If unadjusted URCS significantly underestimates the cost of capital for KCSR, the unadjusted URCS underestimation of class II and class III capital costs is even more exaggerated. Most class II and class III railroads are privately held. They do not have access to the lower cost public equity or debt markets. Lenders and investors expect higher returns from class II and class III railroads that reflect an illiquid and relatively speculative investment. Small railroad capital costs are vastly higher than those of the investment grade class I carriers which URCS assumes, and that discrepancy by itself creates an unadjusted URCS baseline for evaluating small railroad rates which is both capricious and arbitrary in its distortion of actual small railroad costs.

Even more devastating to class II and class III carriers is the unwillingness of the Board to permit movement-specific adjustments to URCS variable costs. Small railroads operate volumes of traffic smaller by many orders of magnitude than the big class I carriers. High costs of specific single car or specialized movements which cannot be passed to the customer without risking a rate action at the STB are not spread among millions of other movements. When small railroads 'eat' actual costs of specific freight movements because of regulatory rate constraints, those costs have material negative impacts on the bottom lines of small carriers, quickly putting the viability of those carriers at risk.

For example, small railroads sometimes move toxic-by-inhalation (TIH) materials such as chlorine gas in tank cars to small communities for local water purification uses. The cost to insure such movements, assuming such insurance is available at all, is staggering and rising every day. Coverage in the hundreds of millions of dollars is needed to reflect the true risk-cost of transporting such materials. Premiums for that extraordinary level TIH insurance overwhelm all the other costs –average and actual – associated with the movement. Yet unadjusted URCS will not permit movement specific insurance costs to be incorporated into its variable cost calculation.

This puts the small carrier in an untenable position. If it incorporates the actual cost of the insurance into its rate for TIH movements, it will draw a rate case in which its rate – inflated by true insurance costs - will greatly exceed 180% of artificially low "unadjusted" URCS variable costs. Since all of the "Three Benchmark" measures are

grounded in unadjusted URCS calculations, the likelihood that rates incorporating actual insurance costs would be determined to be unreasonable is high. In any event the small railroad will be faced with the six-figure cost of defending the "small rate" cases that arise from trying to pass along this actual cost. Since it cannot 'eat' that cost without inflicting serious harm to its financial viability, the only realistic alternative for a small TIH carrier is simply to forego insuring the TIH movement and avoid the premium cost altogether or just insure it at token levels which would not protect it or the public in the event of a major incident. As recent experience unfortunately demonstrates, the damages from a TIH car accident are catastrophic and would instantly bankrupt the largest class II or class III carrier which is not insured for hundreds of millions of dollars. This puts the small railroad enterprise at risk every time it accepts a TIH car. Rate reasonableness procedures based on a costing algorithm that forces small railroads into such 'roll the dice' behavior is antithetical to the Board's obligation to preserve and promote a healthy rail industry that includes small carriers.

The inability of small railroads to recapture the full cost of high limit insurance for specific TIH movements in unadjusted URCS methodologies has grave public policy implications which the Board should carefully contemplate. The cost of comprehensive insurance is really a surrogate measure of the risk to society of transporting dangerous TIH commodities. Small railroads cannot possibly afford the cost of insurance that fully incorporates that risk without passing the cost along in its rate structure. As noted above, since common carriers have an obligation to transport these materials, they will "go bare" or transport the materials without adequate coverage. Should a serious accident occur,

small railroads will be unable to pay even a tiny fraction of any damage claims and will quickly go out of business. Those innocent members of the public who have sustained horrendous damages will have no source from which they can recover their losses.

Class I railroads can and do bear the risk through a combination of multiple layers of insurance and their own deep pockets. Small railroads do not have the deep pockets, and will not carry the insurance if they cannot pass on its high cost to shippers. Thus, so long as the Board insists that movement specific adjustments to URCS variable costs will not be allowed in small rate cases, it is shifting the risks of moving TIH commodities from the railroad to members of the public who may suffer damages as a result of a TIH incident, surely not a desirable public policy outcome. ASLRRA urgently recommends that the Board revise its rulemaking to allow these movement-specific adjustments to URCS variable costs in *all* rate cases.

More fundamentally, ASLRRA believes there are persuasive reasons to exclude class II and class III railroads from the proposed small rate cases altogether. When in 1995 Congress mandated that the Board establish simplified procedures for cases in which a full stand-alone cost presentation is too costly, there is nothing in the record to indicate that Congress had small railroads on its radar screen. Yet the current proposed small rate case procedures inevitably set up a David-vs-Goliath confrontation in which giant multi-billion dollar industrial shippers will challenge rates of small carriers in proceedings where the six-figure cost of litigation is trivial to them, but a life threatening sword of Damocles to the small railroad. Such an intimidating face-off can never truly be

fair. Indeed, ASLRRA believes that large corporate shippers could assail small railroads with numerous 'small rate' cases as a commercial tactic to intimidate them into highly favorable rates regardless of their 'rate reasonableness'. ALSRRA urges the Board to exempt class II and class III railroads from this process. Since the vast majority of shipments of all kinds are made under rates established by class I railroads, eliminating the small railroads from a rate review system designed to deal with huge corporate carriers will have a negligible effect on the ability of the shipping public to obtain rate relief. Exempting small railroads will not abrogate the Board's mandate to provide a streamlined small rate procedure for the vast majority of such shipments and preserves current procedures available to (and already used by) shippers in rate matters involving small railroads. In the event the Board perceives a material need to address small railroad rate issues, ASLRRA recommends the Board initiate a separate proceeding to explore more appropriate methodologies and proceedings that are designed to reflect the realities of small railroads and small shippers.

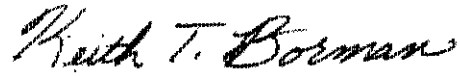
In the alternative if the Board is intent upon imposing its proposed methodologies on all carriers despite their inequitable effect on the small members of the industry, then ASLRRA urges the Board to adopt an additional eligibility requirement along side the maximum case value for the small rate case procedures. In recognition of class II and class III railroads' much more precarious financial condition, their inability to afford six-figure defense costs and their vulnerability to multiple scorched-earth rate attacks by giant corporate shippers, ASLRRA proposes that the Board limit "small rate" cases to shippers of similar size using the same benchmark it uses to classify railroads into class II

and class III categories. Thus, only a shipper whose revenues would qualify it as a class III railroad if it were a carrier could use the "small rate case" procedures against a class III railroad, and no shipper whose revenues are more than would qualify it as a class II railroad could bring a small rate case against a class II railroad. This additional eligibility requirement would at least assure that small carriers would not be targeted by huge shippers solely because they are less able to defend vigorously and adequately against rate challenges which, if successful, could then be bootstrapped for use against the real targets: the class I carriers.

In sum, ASLRRA asserts that the risk to the viability of class II and class III carriers as a result of the proposed small rate case procedures is significant in large part because they appear to have been designed with large-railroad "small rates cases" in mind. It is too facile to conclude that the effects of these rules on the small railroad industry will be minimal because the number of cases brought against small carriers will be small. Even small numbers of rate cases of the kind contemplated by the current proposals will cause the atrophy of some otherwise healthy small railroads either directly through inadequate revenues and excessive defense costs or indirectly through carrier decisions driven by rate case fears rather than desirable public policy outcomes. Either way, the result will not in the long run benefit the shipping public.

Respectfully submitted,

American Short Line and Regional Railroad Association



By: Keith T. Borman

Vice President & General Counsel
American Short Line and Regional Railroad Association
Suite 7020
50 F Street N.W.
Washington, D.C. 20001-1564
Telephone 202-628-4500
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